

FINANCIAL AUDIT  
INCLUDING THE PROVISIONS OF THE SINGLE AUDIT ACT  
OF THE

DEPARTMENT OF TREASURY

October 1, 1999 through September 30, 2001



Michigan  
*Office of the Auditor General*  
**REPORT SUMMARY**

**Financial Audit**

*Including the Provisions of the Single Audit Act  
 October 1, 1999 through September 30, 2001*

**Department of Treasury**

Report Number:  
 27-100-02

Released:  
 June 2002

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with State compliance requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

**Financial Schedules:**

**Auditor's Report Issued**

We issued an unqualified opinion on the Department's financial schedules.

~ ~ ~ ~ ~

**Internal Control Over Financial Reporting**

We identified one material weakness in internal control over financial reporting (Finding 1). We also identified a reportable condition (Finding 2).

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**Noncompliance Material to  
 the Financial Schedules**

We did not identify any instances of noncompliance applicable to the financial schedules that are required to be reported under *Government Auditing Standards*.

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**Federal Awards:**

**Auditor's Reports Issued on Compliance**

We audited 2 programs as major programs and issued 2 unqualified opinions. The federal programs audited as major programs are identified on the back of this summary.

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**Internal Control Over Major Programs**

We did not report any findings related to internal control over major programs.

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**Required Reporting of Noncompliance**

We did not identify any instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133.

~ ~ ~ ~ ~

**Systems of Accounting and Internal Control:**

We determined that the Department was in substantial compliance with Sections

18.1483 - 18.1487 of the *Michigan Compiled Laws*. However, we did identify reportable conditions (Findings 3 and 4).

~ ~ ~ ~ ~

We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program Title</u>	<u>Compliance Opinion</u>
84.185	Byrd Honors Scholarships	Unqualified
93.568	Low-Income Home Energy Assistance	Unqualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: [www.state.mi.us/audgen/](http://www.state.mi.us/audgen/)



Michigan Office of the Auditor General  
201 N. Washington Square  
Lansing, Michigan 48913

**Thomas H. McTavish, C.P.A.**  
Auditor General

**James S. Neubecker, C.P.A., C.I.A., D.P.A.**  
Executive Deputy Auditor General

**Michael J. Mayhew, C.P.A.**  
Deputy Auditor General for Audits



STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
LANSING, MICHIGAN 48913  
(517) 334-8050  
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

June 26, 2002

Dr. Douglas B. Roberts  
State Treasurer  
Treasury Building  
Lansing, Michigan

Dear Dr. Roberts:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Treasury for the period October 1, 1999 through September 30, 2001.

This report contains our report summary, our independent auditor's report on the financial schedules and the Department of Treasury financial schedules, notes to the financial schedules, and supplemental financial schedules. This report also contains our independent auditor's reports on compliance and on internal control over financial reporting and on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133 and our schedule of findings and questioned costs. In addition, this report contains the Department's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our findings and recommendations are contained in Section II of the schedule of findings and questioned costs. The agency preliminary responses are contained in the corrective action plan. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
LANSING, MICHIGAN 48913  
(517) 334-8050  
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

## Independent Auditor's Report on the Financial Schedules

April 17, 2002

Dr. Douglas B. Roberts  
State Treasurer  
Treasury Building  
Lansing, Michigan

Dear Dr. Roberts:

We have audited the accompanying schedule of revenue and other financing sources - General Fund, special revenue funds, debt service funds, and private purpose trust fund and the schedule of sources and disposition of General Fund authorizations of the Department of Treasury for the fiscal years ended September 30, 2001 and September 30, 2000. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit. The governmental operations of the Department are accounted for principally in the General Fund of the State of Michigan. In addition, the Department is responsible for collecting settlements and fees for various special revenue funds, managing cash and debt for various debt service funds, and administering escheated property.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Notes 1b and 1c, the accompanying financial schedules include only the revenue and other financing sources and the sources and disposition of

authorizations for the Department's General Fund accounts, presented on the modified accrual basis of accounting; the revenue and other financing sources for the Department's special revenue funds and debt service funds, presented on the modified accrual basis of accounting; and the revenue and other financing sources for the Department's private purpose trust fund, presented on the accrual basis of accounting. Accordingly, these financial schedules are not intended to constitute a complete financial presentation of the Department or the State's General Fund, its special revenue funds, its debt service funds, or its private purpose trust funds in accordance with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenue and other financing sources and the sources and disposition of authorizations of the Department of Treasury for the fiscal years ended September 30, 2001 and September 30, 2000, on the basis of accounting described in Note 1b.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 17, 2002 on our tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and other supplemental financial schedules, consisting of the schedule of revenue and other financing sources - special revenue funds and the schedule of revenue and other financing sources - debt service funds, are presented for purposes of additional analysis and are not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

AUDITOR GENERAL

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**DEPARTMENT OF TREASURY**  
Schedule of Revenue and Other Financing Sources  
General Fund, Special Revenue Funds, Debt Service Funds,  
and Private Purpose Trust Fund  
Fiscal Years Ended September 30  
(in thousands)

	General Fund		Special Revenue Funds	
	2001	2000	2001	2000
<b>REVENUE</b>				
Taxes (net of refunds):				
Personal income tax	\$ 5,326,426	\$ 5,677,550	\$	\$
Single business tax	2,022,882	2,324,868		
Sales tax	1,388,066	1,379,969		
Use tax	789,262	791,175		
Tobacco products tax	169,552	172,535		
Intangibles tax	(334)	327		
Estate and inheritance tax	155,468	185,526		
Telephone company tax	152,523	149,206		
Commercial mobile radio tax	28,756	12,303		
Insurance company tax	194,191	186,195		
Gas and oil severance tax	60,139	43,886		
Convention facility development tax	45,962	45,630		
Airport parking tax	17,059	16,982		
Penalties and interest - various taxes	157,377	137,797		
Other taxes	1,786	5,833		
Total Taxes	<u>\$ 10,509,115</u>	<u>\$ 11,129,782</u>	<u>\$ 0</u>	<u>\$ 0</u>
From federal agencies	<u>\$ 3,196</u>	<u>\$ 2,924</u>	<u>\$</u>	<u>\$</u>
From local agencies	<u>\$ 5,588</u>	<u>\$ 1,431</u>	<u>\$</u>	<u>\$</u>
From services	<u>\$ 16,877</u>	<u>\$ 15,260</u>	<u>\$ 1</u>	<u>\$</u>
From licenses and permits	<u>\$ 366</u>	<u>\$ 324</u>	<u>\$ 150</u>	<u>\$ 64</u>
Miscellaneous:				
Income from investments	\$ 49,810	\$ 63,567	\$ 15,580	\$ 14,315
From tobacco settlement proceeds			261,248	244,639
Various fines, fees, and assessments			26,197	17,183
Escheated property (net of claims)				
Other miscellaneous	22,991	10,939	5,018	5,272
Total Miscellaneous	<u>\$ 72,801</u>	<u>\$ 74,506</u>	<u>\$ 308,043</u>	<u>\$ 281,409</u>
Total Revenue	<u>\$ 10,607,943</u>	<u>\$ 11,224,227</u>	<u>\$ 308,194</u>	<u>\$ 281,473</u>
<b>OTHER FINANCING SOURCES</b>				
Bonds and notes issued (Note 3)	\$	\$	\$ 81,300	\$
Premium on bond issuance			301	
Refunding bonds issued (Note 4)			37	
Capital lease acquisitions		172		
Transfers from other funds	107,287	114,088		
Total Other Financing Sources	<u>\$ 107,287</u>	<u>\$ 114,260</u>	<u>\$ 81,638</u>	<u>\$ 0</u>
Total Revenue and Other Financing Sources	<u>\$ 10,715,230</u>	<u>\$ 11,338,487</u>	<u>\$ 389,832</u>	<u>\$ 281,473</u>

The accompanying notes are an integral part of the financial schedules.

Debt Service Funds		Private Purpose Trust Fund		Totals (Memorandum Only)	
2001	2000	2001	2000	2001	2000
\$	\$	\$	\$	\$ 5,326,426	\$ 5,677,550
				2,022,882	2,324,868
				1,388,066	1,379,969
				789,262	791,175
				169,552	172,535
				(334)	327
				155,468	185,526
				152,523	149,206
				28,756	12,303
				194,191	186,195
				60,139	43,886
				45,962	45,630
				17,059	16,982
				157,377	137,797
				1,786	5,833
<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 10,509,115</u>	<u>\$ 11,129,782</u>
\$	\$	\$	\$	\$ 3,196	\$ 2,924
\$	\$	\$	\$	\$ 5,588	\$ 1,431
\$	\$	\$	\$	\$ 16,878	\$ 15,260
\$	\$	\$	\$	\$ 516	\$ 388
\$ 3,510	\$ 2,226	\$	\$	\$ 68,900	\$ 80,108
				261,248	244,639
		33,492	43,785	26,197	17,183
				33,492	43,785
(8)				28,001	16,211
<u>\$ 3,502</u>	<u>\$ 2,226</u>	<u>\$ 33,492</u>	<u>\$ 43,785</u>	<u>\$ 417,838</u>	<u>\$ 401,926</u>
<u>\$ 3,502</u>	<u>\$ 2,226</u>	<u>\$ 33,492</u>	<u>\$ 43,785</u>	<u>\$ 10,953,131</u>	<u>\$ 11,551,711</u>
\$	\$	\$	\$	\$ 81,300	\$ 0
				301	0
196,837				196,874	0
				0	172
<u>149,357</u>	<u>143,390</u>	<u>740</u>	<u>155</u>	<u>257,384</u>	<u>257,633</u>
<u>\$ 346,194</u>	<u>\$ 143,390</u>	<u>\$ 740</u>	<u>\$ 155</u>	<u>\$ 535,859</u>	<u>\$ 257,805</u>
<u>\$ 349,696</u>	<u>\$ 145,616</u>	<u>\$ 34,232</u>	<u>\$ 43,940</u>	<u>\$ 11,488,990</u>	<u>\$ 11,809,516</u>

DEPARTMENT OF TREASURY  
Schedule of Sources and Disposition of General Fund Authorizations  
Fiscal Years Ended September 30  
(in thousands)

	<u>2001</u>	<u>2000</u>
<b>SOURCES OF AUTHORIZATIONS (Note 2)</b>		
General purpose appropriations	\$ 282,828	\$ 284,899
Budgetary transfers in (out)		1,060
Balances carried forward	278,237	267,622
Restricted financing sources	2,325,595	2,186,078
Less: Intrafund expenditure reimbursements	<u>(36,034)</u>	<u>(25,508)</u>
 Total	 <u>\$ 2,850,626</u>	 <u>\$ 2,714,151</u>
 <b>DISPOSITION OF AUTHORIZATIONS (Note 2)</b>		
Gross expenditures and transfers	\$ 2,589,541	\$ 2,450,786
Less: Intrafund expenditure reimbursements	<u>(36,034)</u>	<u>(25,508)</u>
Net expenditures and transfers	<u>\$ 2,553,507</u>	<u>\$ 2,425,278</u>
Balances carried forward:		
Multi-year projects	\$ 15,277	\$ 27,734
Encumbrances	6,128	4,339
Restricted revenue - authorized	3,212	3,647
Restricted revenue - not authorized	<u>269,121</u>	<u>242,517</u>
Total balances carried forward	<u>\$ 293,738</u>	<u>\$ 278,237</u>
Balances lapsed	<u>\$ 3,381</u>	<u>\$ 10,636</u>
 Total	 <u>\$ 2,850,626</u>	 <u>\$ 2,714,151</u>

The accompanying notes are an integral part of the financial schedules.

## Notes to the Financial Schedules

### Note 1 Significant Accounting Policies

#### a. Reporting Entity

The accompanying financial schedules report the results of the governmental operations of the Department of Treasury for the fiscal years ended September 30, 2001 and September 30, 2000. The governmental operations of the Department are accounted for principally in the State's General Fund and are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. Other Department operations, related to casino gaming, the Michigan Merit Award Scholarship Program, cash and debt management, and escheated property, are accounted for in various other funds and reported on in the *SOMCAFR*.

The Department administers the following funds:

#### Governmental - Special Revenue

Tobacco Settlement Trust Fund

Michigan Merit Award Trust Fund

School Bond Loan Fund

State Casino Gaming Fund

Michigan Underground Storage Tank Financial Assurance Finance  
Authority

Special Assessment Deferment Fund

#### Governmental - Debt Service

Recreation and Environmental Protection Bond Redemption Fund

School Loan Bond Redemption Fund

Michigan Underground Storage Tank Financial Assurance Finance  
Authority

#### Fiduciary - Private Purpose Trust

Escheats Fund

The accompanying financial schedules also report certain financial transactions of the Michigan Higher Education Student Loan Authority and the Michigan Higher Education Assistance Authority that are under the direction of the State Treasurer and accounted for in the Department's General Fund. These non-major component units are a part of the State of Michigan's reporting entity and are reported on in the *SOMCAFR*.

The notes accompanying these financial schedules relate directly to the Department. The *SOMCAFR* provides more extensive general disclosures regarding the State's Summary of Significant Accounting Policies; Budgeting, Budgetary Control, and Legal Compliance; Treasurer's Common Cash; Deposits and Investments; Pension Benefits and Other Postemployment Benefits; Compensated Absences; and Contingencies and Commitments.

b. Basis of Accounting

The financial information contained in this report for the General Fund, special revenue funds, and debt service funds is reported using the current financial resources measurement focus and the modified accrual basis of accounting, as provided by accounting principles generally accepted in the United States of America for governmental funds. The current financial resources measurement focus and the modified accrual basis of accounting are explained in more detail in the *SOMCAFR*. The financial information relating to the private purpose trust fund is reported using the economic resources measurement focus and the accrual basis of accounting, as provided by accounting principles generally accepted in the United States of America for fiduciary funds. The economic resources measurement focus and the accrual basis of accounting are explained in more detail in the *SOMCAFR*.

c. Basis of Presentation

The accompanying schedule of revenue and other financing sources is not intended to report all revenue collected by the Department of Treasury. The schedule presents revenue resulting from the Department's administration of the State's major tax laws and certain other revenue and federal revenue generated by the Department's various programs and interdepartmental services. These revenues are accounted for principally in the State's General Fund. The accompanying schedule of sources and

disposition of General Fund authorizations includes the Department of Treasury's General Fund accounts. Accordingly, these financial schedules are not intended to constitute a complete financial presentation of the Department or the State's General Fund, its special revenue funds, its debt service funds, or its private purpose trust funds in accordance with accounting principles generally accepted in the United States of America.

The Department's various individual funds are combined in the *SOMCAFR* into fund types described as follows:

#### Governmental Fund Types

Special Revenue Funds: This fund type includes operating fund activities financed by specific revenue sources that are legally restricted for specified purposes.

Debt Service Funds: This fund type accounts for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

#### Fiduciary Fund Types

Private Purpose Trust Funds: This fund type reports resources of trust arrangements in which the principal and income benefit individuals, private organizations, or other governments.

#### Totals (Memorandum Only)

Amounts in the "Totals (Memorandum Only)" column represent summations of the governmental and fiduciary fund types and are presented only for analytical purposes. Consequently, amounts shown are not comparable to a consolidation.

Note 2 Schedule of Sources and Disposition of General Fund Authorizations

The various elements of the schedule of sources and disposition of General Fund authorizations are defined as follows:

- a. General purpose appropriations: Original appropriations and any supplemental appropriations that are financed by General Fund/general purpose revenue.
- b. Budgetary transfers in (out): Legislatively approved transfers of spending authorization between accounts within a department or between departments. These also include administrative transfers, such as entries to complete the financial closing of the State's fiscal year, that are approved by the Office of Financial Management, Department of Management and Budget.
- c. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenue - authorized, and restricted revenue - not authorized that were not spent as of the end of the prior fiscal year. These authorizations are available for expenditure in the current fiscal year for the purpose of the carry-forward without additional legislative authorization, except for the restricted revenue - not authorized.
- d. Restricted financing sources: Collections of restricted revenue, restricted transfers, and restricted intrafund expenditure reimbursements to finance programs as detailed in the appropriations act. These financing sources are authorized for expenditure up to the amount appropriated. Depending upon program statute, any amounts received in excess of the appropriation are, at year-end, either converted to general purpose financing sources and made available for general appropriation in the next fiscal year or carried forward to the next fiscal year as either restricted revenue - authorized or restricted revenue - not authorized.
- e. Intrafund expenditure reimbursements: Funding from other General Fund departments to finance a program or a portion of a program that is the responsibility of the receiving department.

- f. Multi-year projects: Unexpended authorizations for work projects and capital outlay projects that are carried forward to subsequent fiscal years for the completion of the projects.
- g. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered in the old fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.
- h. Restricted revenue - authorized: Revenue that, by statute or the State Constitution, is restricted and authorized for use to a particular program or activity. Generally, this revenue may be expended upon receipt without additional legislative authorization.
- i. Restricted revenue - not authorized: Revenue that, by statute, is restricted for use to a particular program or activity. However, the Department had not received legislative authorization to expend the revenue.
- j. Balances lapsed: Authorizations that were unexpended and unobligated at the end of the fiscal year. These amounts are available for legislative appropriation in the subsequent fiscal year.

Note 3 Bonded Debt

General Obligation Bonded Debt: Article IX, Section 15 of the State Constitution authorizes general obligation long-term borrowing, subject to approval by the Legislature and a majority of voters at a general election. In 2001, the State of Michigan issued Series 2001A Multi-Modal General Obligation School Loan Bonds in the amount of \$81.3 million. The 2001A bonds are the first series of bonds issued under a trust authorizing the issuance of Multi-Modal General Obligation School Loan Bonds not to exceed \$250 million. These bonds refinanced the Series 2000 School Loan Notes in the amount of \$44.5 million and provided funds to make loans to school districts.

Note 4 Bond Refunding

Advanced Refunding and Defeasance: In 2001, the State of Michigan issued Series 2001 General Obligation Refunding Bonds in the amount of \$183.3 million to finance the advanced refunding of selected bond issues. The present value of the refunding bonds, included in the accompanying schedule of revenue and other financing sources for the debt service funds, totaled \$196.8 million as follows:

Summary of Refunding Transactions  
(in millions)

	Refunds the Environmental Protection Program Bonds	Refunds the School Loan Bonds	Refunds the Recreation Program Bonds	Total
Bond Proceeds:				
Par amount	\$ 86.1	\$ 85.3	\$ 11.8	\$ 183.3
Premium	6.5	6.5	0.6	13.5
Total	<u>\$ 92.6</u>	<u>\$ 91.8</u>	<u>\$ 12.4</u>	<u>\$ 196.8</u>

The refunding bonds issued resulted in the partial defeasance of \$13.5 million and \$74.4 million of the Series 1992 and 1995 Environmental Protection Program Bonds, respectively; \$84.5 million of the Series 1995 School Loan Bonds; and \$11.8 million of the Series 1995 Recreation Program Bonds. The refunding transaction resulted in a present gain of \$5.6 million and a future savings of \$10.8 million. The proceeds of the refunding issues were placed in trust with an escrow agent to provide for all future service on the defeased bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not recorded on the Department of Treasury's accounting records as the Department defeased its obligation for payment of the refunded bond debt upon completion of the refunding transaction.

Note 5 Contingencies

Litigation: The Department is party to a legal proceeding seeking tax relief that, if taxpayers succeed in the lawsuit, will result in a loss. On November 24,

1999, the Michigan Court of Claims in *Jefferson Smurfit Corporation v State of Michigan*, File No. 98-17140-CM, ruled that the site-based capital acquisition deduction in Michigan's single business tax is unconstitutional. According to the Department, the potential financial impact of this decision is approximately \$261 million. The State has appealed the decision. On November 13, 2001, the Michigan Court of Appeals issued its opinion reversing the decision of the lower court and holding that the capital acquisition deduction did not violate constitutional provisions. It is anticipated that the taxpayers will seek reconsideration or will file their application for leave to appeal with the Michigan Supreme Court.

#### Note 6 Subsequent Events

a. Long-Term Borrowing

In October 2001, the Department of Treasury issued school loan bonds totaling \$47.1 million to finance loans to school districts.

b. Executive Order No. 2002-3

On March 12, 2002, the Governor issued Executive Order No. 2002-3, which created the Michigan Public Educational Facilities Authority within the Department. The Executive Order transferred the Michigan Municipal Bond Authority and certain Michigan Strategic Fund responsibilities related to public educational facilities, including the power to issue bonds and notes and enter into contracts, to the newly created Authority.

c. Act 49, P.A. 2002

Effective March 14, 2002, Act 49, P.A. 2002, created the Michigan Broadband Development Authority within the Department. The Authority was created to expand the broadband infrastructure by providing broadband services throughout the State. The duties of the Authority are exercised through its board of directors.

#### Note 7 Differences From the State's General Accounting System

The Department accounted for and reported federal revenue and related administrative expenditures of the student financial assistance programs in the General Fund in fiscal year 1999-2000. The revenue and expenditures were also reported in the financial statements of the Michigan Higher Education Assistance Authority and the Michigan Higher Education Student Loan

Authority, which are discretely presented component units of the State as presented in the *SOMCAFR*. This dual accounting and reporting resulted in federal revenue being overstated in the amount of \$21,881,538 and intrafund expenditures being understated in the amount of \$21,881,538.

As a result, the schedule of revenue and other financing sources - General Fund, special revenue funds, debt service funds, and private purpose trust fund was adjusted for the fiscal year ended September 30, 2000 from the amount reported in the fiscal year 1999-2000 *SOMCAFR*. The General Fund federal revenue was decreased by \$21,881,538. Additionally, the schedule of sources and disposition of General Fund authorizations was adjusted for the fiscal year ended September 30, 2000 from the amount reported in the fiscal year 1999-2000 *SOMCAFR*. Intrafund expenditure reimbursements were increased by \$21,881,538.

# SUPPLEMENTAL FINANCIAL SCHEDULES

## Descriptions of Special Revenue Funds

### TOBACCO SETTLEMENT TRUST FUND

Act 489, P.A. 2000, created this Fund to account for a portion of the revenue from the master settlement agreement between tobacco manufacturers and the State. The settlement reimburses the State for health care costs, which result from the use of tobacco products. Expenditures from the Fund are for a variety of programs as determined by the Legislature.

### MICHIGAN MERIT AWARD TRUST FUND

Expenditures from the Fund are primarily for the Michigan Merit Award Scholarship Program. This Fund was created by Act 94, P.A. 1999, to account for a portion of the revenue from the master settlement agreement between tobacco manufacturers and the State.

### SCHOOL BOND LOAN FUND

Article IX, Section 16 of the State Constitution; Act 74, P.A. 1955; and Act 112, P.A. 1961 authorized the issuance of State general obligation bonds to provide funds for loans to school districts. Loans are made for the payment of principal and interest on school district bonds under prescribed circumstances. The proceeds of State bonds are credited to the Fund as an "Other Financing Source." When loans are made, transfers are recorded to the General Fund, which receives loan payments and provides financing for debt service. The loans receivable are recorded as assets in the General Fund.

### STATE CASINO GAMING FUND

The Fund was created by Act 69, P.A. 1997, to provide for the licensing, regulation, and control of casino gaming activities in Michigan. The five-member gaming control board is vested with authority for licensing, regulating, and controlling casino gaming operations; manufacturers and distributors of gaming equipment and supplies; and persons who participate in gaming. Casino gaming revenue is legally restricted for specific purposes.

### MICHIGAN UNDERGROUND STORAGE TANK FINANCIAL ASSURANCE (MUSTFA) FINANCE AUTHORITY

The MUSTFA Finance Authority was established in 1993 and operates under Part 215 of Act 451, P.A. 1994, as amended, to provide financing for the activities of the

Michigan Underground Storage Tank Financial Assurance Fund, including short- or long-term debt instruments. The Authority is governed by a five-member board of directors.

#### SPECIAL ASSESSMENT DEFERMENT FUND

Established by Act 225, P.A. 1976, as amended, the purpose of the Fund is to defer the collection of special assessments on homestead properties of senior citizens and totally and permanently disabled persons. Reimbursement is made by the individual or the applicable county treasurer.

DEPARTMENT OF TREASURY  
Schedule of Revenue and Other Financing Sources  
Special Revenue Funds  
Fiscal Years Ended September 30  
(in thousands)

	<u>Tobacco Settlement Trust Fund</u>		<u>Michigan Merit Award Trust Fund</u>		<u>School Bond Loan Fund</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
<b>REVENUE</b>						
From services	\$	\$	\$	\$	\$	\$
From licenses and permits	\$	\$	\$	\$	\$	\$
Miscellaneous:						
Income from investments	\$ 10,959	\$ 10,171	\$ 4,617	\$ 4,136	\$	\$
From tobacco settlement proceeds	130,624	171,247	130,624	73,392		
Various fines, fees, and assessments						
Other miscellaneous			3,887			
Total Miscellaneous	<u>\$ 141,583</u>	<u>\$ 181,418</u>	<u>\$ 139,128</u>	<u>\$ 77,528</u>	<u>\$ 0</u>	<u>\$ 0</u>
Total Revenue	<u>\$ 141,583</u>	<u>\$ 181,418</u>	<u>\$ 139,128</u>	<u>\$ 77,528</u>	<u>\$ 0</u>	<u>\$ 0</u>
<b>OTHER FINANCING SOURCES</b>						
Bonds and notes issued	\$	\$	\$	\$	\$ 81,300	\$
Premium on bond issuance					301	
Refunding bonds issued					37	
Total Other Financing Sources	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 81,638</u>	<u>\$ 0</u>
Total Revenue and Other Financing Sources	<u>\$ 141,583</u>	<u>\$ 181,418</u>	<u>\$ 139,128</u>	<u>\$ 77,528</u>	<u>\$ 81,638</u>	<u>\$ 0</u>

The amounts shown represent only the amounts collected by the Department of Treasury and do not necessarily represent total revenue for the funds.

State Casino Gaming Fund		Michigan Underground Storage Tank Financial Assurance Finance Authority		Special Assessment Deferment Fund		Totals (Memorandum Only)	
2001	2000	2001	2000	2001	2000	2001	2000
\$ 1	\$	\$	\$	\$	\$	\$ 1	\$ 0
\$ 150	\$ 64	\$	\$	\$	\$	\$ 150	\$ 64
\$	\$	\$ 4	\$ 8	\$	\$	\$ 15,580	\$ 14,315
26,154	17,043			43	140	261,248	244,639
962	2,439	169	2,833			26,197	17,183
\$ 27,116	\$ 19,482	\$ 173	\$ 2,841	\$ 43	\$ 140	\$ 308,043	\$ 281,409
\$ 27,267	\$ 19,546	\$ 173	\$ 2,841	\$ 43	\$ 140	\$ 308,194	\$ 281,473
\$	\$	\$	\$	\$	\$	\$ 81,300	\$ 0
						301	0
						37	0
\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 81,638	\$ 0
\$ 27,267	\$ 19,546	\$ 173	\$ 2,841	\$ 43	\$ 140	\$ 389,832	\$ 281,473

## Description of Debt Service Funds

### RECREATION AND ENVIRONMENTAL PROTECTION BOND REDEMPTION FUND

Acts 326 and 327, P.A. 1998, established this Fund to service bond issues of the Recreation Bond Fund - Local Projects, Recreation Bond Fund - State Projects, and the Environmental Protection Bond Fund. Also, pursuant to Act 284, P.A. 1998, and Part 196 of Act 451, P.A. 1994, the Fund services bond issues of the Clean Michigan Initiative Bond Fund - Local Projects, Clean Michigan Initiative Bond Fund - State Projects, and Clean Michigan Initiative Bond Fund - Environmental Projects. Financing of debt retirement, interest expense, and paying agent fees is provided by annual legislative appropriation from the General Fund.

### SCHOOL LOAN BOND REDEMPTION FUND

Act 74, P.A. 1955, and Act 112, P.A. 1961, created this Fund to account for debt service on general obligation bonds issued to finance loans to local school districts. The School Bond Loan Fund, a special revenue fund, receives the State bond proceeds and makes the loans. The Legislature appropriates funds from the General Fund to meet principal and interest requirements and paying agent fees.

### MICHIGAN UNDERGROUND STORAGE TANK FINANCIAL ASSURANCE (MUSTFA) FINANCE AUTHORITY

The MUSTFA Finance Authority was established in 1993 and operates under Part 215 of Act 451, P.A. 1994, as amended, to provide financing for the activities of the Michigan Underground Storage Tank Financial Assurance Fund, including short- or long-term debt instruments. The Authority is governed by a five-member board of directors.

DEPARTMENT OF TREASURY  
Schedule of Revenue and Other Financing Sources  
Debt Service Funds  
Fiscal Years Ended September 30  
(in thousands)

	Recreation and Environmental Protection Bond Redemption Fund		School Loan Bond Redemption Fund		Michigan Underground Storage Tank Financial Assurance Finance Authority		Totals (Memorandum Only)	
	2001	2000	2001	2000	2001	2000	2001	2000
REVENUE								
Income from investments	\$	\$	\$	\$	\$ 3,510	\$ 2,226	\$ 3,510	\$ 2,226
Miscellaneous					(8)		(8)	0
Total Revenue	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 3,502</u>	<u>\$ 2,226</u>	<u>\$ 3,502</u>	<u>\$ 2,226</u>
OTHER FINANCING SOURCES								
Refunding bonds issued	\$ 105,054	\$	\$ 91,783	\$	\$	\$	\$ 196,837	\$ 0
Transfers:								
From General Fund	\$ 64,682	\$ 62,863	\$ 26,763	\$ 22,755	\$	\$	\$ 91,445	\$ 85,618
From special revenue funds					57,912	57,772	57,912	57,772
Total transfers	<u>\$ 64,682</u>	<u>\$ 62,863</u>	<u>\$ 26,763</u>	<u>\$ 22,755</u>	<u>\$ 57,912</u>	<u>\$ 57,772</u>	<u>\$ 149,357</u>	<u>\$ 143,390</u>
Total Other Financing Sources	<u>\$ 169,736</u>	<u>\$ 62,863</u>	<u>\$ 118,546</u>	<u>\$ 22,755</u>	<u>\$ 57,912</u>	<u>\$ 57,772</u>	<u>\$ 346,194</u>	<u>\$ 143,390</u>
Total Revenue and Other Financing Sources	<u>\$ 169,736</u>	<u>\$ 62,863</u>	<u>\$ 118,546</u>	<u>\$ 22,755</u>	<u>\$ 61,414</u>	<u>\$ 59,998</u>	<u>\$ 349,696</u>	<u>\$ 145,616</u>

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## Description of Private Purpose Trust Fund

### ESCHEATS FUND

This Fund operates under the authority of Act 29, P.A. 1995, and is used to account for unclaimed property escheated to the State. All property, including any income or increment derived from the property, is subject to the custody of (escheated to) the State when certain criteria contained within the Act are met. Proceeds of the Fund pay the administrative costs and prompt claims allowed under this Act. The administrator transfers all remaining proceeds received under this Act to the General Fund.

The private purpose trust fund's financial information appears on page 11.

DEPARTMENT OF TREASURY  
Schedule of Expenditures of Federal Awards (Note 1)  
For the Period October 1, 1999 through September 30, 2001

		For the Fiscal Year Ended September 30, 2000			
Federal Agency/Program	CFDA*	Pass-Through Identification Number	Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<b><u>U.S. Department of Education</u></b>					
Direct Programs:					
Leveraging Educational Assistance Partnership	84.069		\$ 1,055,734	\$	\$ 1,055,734
Byrd Honors Scholarships	84.185		1,438,500		1,438,500
<b>Total U.S. Department of Education</b>			<b>\$ 2,494,234</b>	<b>\$ 0</b>	<b>\$ 2,494,234</b>
<b><u>U.S. Department of Health and Human Services</u></b>					
Pass-Through Programs:					
Family Independence Agency					
Low-Income Home Energy Assistance (Note 2)	93.568	Not Assigned	\$ 750,000	\$	\$ 750,000
<b>Total U.S. Department of Health and Human Services</b>			<b>\$ 750,000</b>	<b>\$ 0</b>	<b>\$ 750,000</b>
Total Expenditures of Federal Awards (Note 3)			<b>\$ 3,244,234</b>	<b>\$ 0</b>	<b>\$ 3,244,234</b>

\* CFDA is defined as *Catalog of Federal Domestic Assistance*.

The accompanying notes are an integral part of this supplemental financial schedule.

<u>For the Fiscal Year Ended September 30, 2001</u>			
<u>Directly Expended</u>	<u>Distributed to Subrecipients</u>	<u>Total Expended and Distributed</u>	<u>Total Expended and Distributed for the Two-Year Period</u>
\$ 1,748,072	\$	\$ 1,748,072	\$ 2,803,806
<u>1,447,500</u>		<u>1,447,500</u>	<u>2,886,000</u>
<b><u>\$ 3,195,572</u></b>	<b><u>\$ 0</u></b>	<b><u>\$ 3,195,572</u></b>	<b><u>\$ 5,689,806</u></b>
<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$ 750,000</u>
<b><u>\$ 0</u></b>	<b><u>\$ 0</u></b>	<b><u>\$ 0</u></b>	<b><u>\$ 750,000</u></b>
<u>\$ 3,195,572</u>	<u>\$ 0</u>	<u>\$ 3,195,572</u>	<u>\$ 6,439,806</u>

## Notes to the Schedule of Expenditures of Federal Awards

### Note 1 Basis of Presentation

This schedule includes the federal grant activity of the Department of Treasury and the Michigan Higher Education Assistance Authority under the direction of the Department of Treasury and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial schedules.

### Note 2 Low-Income Home Energy Assistance

During this audit, the Department was determined to be a vendor providing specific services to the Family Independence Agency (FIA) rather than a subrecipient with program compliance responsibilities. In fiscal year 1999-2000, the funding was accounted for as amounts received by the Department as a subrecipient and audited in this Single Audit. In fiscal year 2000-01, the Department revised its accounting for the program to reflect the vendor relationship and recorded FIA's reimbursement of services as an expenditure credit. Consequently, the funding for fiscal year 2000-01 and in subsequent years will be subject to audit as a part of the FIA Single Audit.

### Note 3 Write-Off of Accounts Receivable

There is a difference between total expenditures of federal awards and federal revenue reported on the Department's schedule of revenue and other financing sources - General Fund, special revenue funds, debt service funds, and private purpose trust fund totaling \$320,378 in fiscal year 1999-2000. This is the result of a write-off by the Department during the fiscal year of a fiscal year 1995-96 federal account receivable related to interest due the Department according to the Cash Management Improvement Act.

# INDEPENDENT AUDITOR'S REPORTS ON COMPLIANCE AND INTERNAL CONTROL



STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
LANSING, MICHIGAN 48913  
(517) 334-8050  
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

## Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting

April 17, 2002

Dr. Douglas B. Roberts  
State Treasurer  
Treasury Building  
Lansing, Michigan

Dear Dr. Roberts:

We have audited the financial schedules of the Department of Treasury for the fiscal years ended September 30, 2001 and September 30, 2000 and have issued our report thereon dated April 17, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

### Compliance

As part of obtaining reasonable assurance about whether the Department's financial schedules are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial schedules and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over

financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial schedules. Reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 1 and 2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions identified in the previous paragraph, we consider Finding 1 to be a material weakness.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL



STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
LANSING, MICHIGAN 48913  
(517) 334-8050  
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

Independent Auditor's Report on Compliance With  
Requirements Applicable to Each Major Program  
and on Internal Control Over Compliance in  
Accordance With OMB Circular A-133

April 17, 2002

Dr. Douglas B. Roberts  
State Treasurer  
Treasury Building  
Lansing, Michigan

Dear Dr. Roberts:

Compliance

We have audited the compliance of the Department of Treasury with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each major federal program for the fiscal years ended September 30, 2001 and September 30, 2000. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our

opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department of Treasury complied, in all material respects, with the requirements referred to in the second previous paragraph that are applicable to each major federal program for the fiscal years ended September 30, 2001 and September 30, 2000.

#### Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

# SCHEDULE OF FINDINGS AND QUESTIONED COSTS\*

## Section I: Summary of Auditor's Results

### Financial Schedules

Type of auditor's report issued: Unqualified\*

Internal control\* over financial reporting:

Material weakness\* identified? Yes

Reportable condition\* identified that is not considered to be  
a material weakness? Yes

Noncompliance material to the financial schedules? No

### Federal Awards

Internal control over major programs:

Material weaknesses identified? No

Reportable conditions identified that are not considered to be  
material weaknesses? None reported

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in  
accordance with U.S. Office of Management and Budget (OMB)  
Circular A-133, Section 510(a)? No

\* See glossary at end of report for definition.

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
84.185	Byrd Honors Scholarships
93.568	Low-Income Home Energy Assistance

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as a low-risk auditee\*? No

## Section II: Findings Related to the Financial Schedules

### **FINDING (270201)**

#### 1. Service Organization Controls

The Department of Treasury did not obtain assurances regarding the effectiveness of the internal control of the financial institution contracted to collect and process the majority of the State's tax revenue. We consider this to be a material internal control weakness.

The financial institution (a service organization) has significant responsibility for the initial receipt, distribution, and deposit of the State's annual tax revenue into the State Treasurer's account. It collects and processes State revenue through various lockboxes and courier delivery. In fiscal year 2000-01, the financial institution collected and processed approximately \$21 billion.

Section 18.1485 of the *Michigan Compiled Laws* requires that the Department establish and maintain an internal accounting and administrative control system for the management of its financial affairs including internal control techniques that are effective and efficient. Obtaining assurances about the effectiveness of the internal control of contracted service organizations is necessary to ensure that assets are properly safeguarded and that financial information is materially correct. This assurance can be obtained from a specialized internal control audit referred to as

\* See glossary at end of report for definition.

an American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards No. 70 (SAS-70) audit performed by an independent auditor. A SAS-70 audit is needed for service organizations that initiate, process, or maintain data affecting the Department's financial schedules and these activities are subjected to controls that are, at least in part, physically and operationally separate from the Department's own internal control.

The Department informed us that, in lieu of committing State resources for a SAS-70 audit, it relied on the financial institution's written policies and procedures and performed reconciliations of cash receipt batch totals to ensure that collections were properly processed. Also, the Department conducted periodic visits to the financial institution to observe its data entry and batch processing. However, we found that the Department reconciled the amount of collections that the financial institution asserted was collected to the daily bank statement prepared by the financial institution. This reconciliation did not provide for an independent verification that all receipts collected by the financial institution were deposited into the State Treasurer's account. Also, the Department did not document the timing, scope, or results of the visits. We determined that these efforts did not constitute a compensating control that would provide the appropriate level of assurance regarding the effectiveness of the financial institution's internal control.

Obtaining assurances regarding the effectiveness of a service organization's internal control reduces the risk that cash receipts could be lost or misappropriated or that the State's tax revenues are understated.

## **RECOMMENDATION**

We recommend that the Department obtain assurances regarding the effectiveness of the internal control of the financial institution contracted to collect and process the majority of the State's tax revenue.

## **FINDING (270202)**

### **2. Approval Controls**

The Department did not maintain sufficient documentation to support the approval of revenue transactions.

Section 18.1485 of the *Michigan Compiled Laws* requires the Department to establish and maintain an internal accounting and administrative control system. The internal control should provide a system of authorization and recordkeeping procedures to control revenues and expenditures.

We tested revenue transactions recorded by the Department during fiscal years 2000-01 and 1999-2000. Of 123 and 144 revenue transactions examined, documentation was unavailable to verify approval for 39 (32%) and 35 (24%) transactions totaling approximately \$4.59 billion and \$4.36 billion in fiscal years 2000-01 and 1999-2000, respectively.

Several users had the capability to approve and release various transactions. However, the Michigan Administrative Information Network\* (MAIN) does not record the users who approve and release each transaction. Because MAIN does not record this information, compensating controls are needed to help ensure that a documentation trail is maintained for the approval and release of each revenue transaction. For example, the Department informed us that, as a compensating control, the user signed a printed MAIN batch control screen for some of the wire/electronic funds transfer (EFT) deposits. However, this did not apply to all daily deposits and the signed printed screens were retained for only a couple months.

Approval documentation is essential to provide an appropriate level of assurance that deposits are recorded at the proper amount and in the proper fiscal year and that revenue is properly classified in the Department's accounting records and financial reports.

## **RECOMMENDATION**

We recommend that the Department maintain sufficient documentation to support the approval of revenue transactions.

\* See glossary at end of report for definition.

## **FINDING (270203)**

### **3. Report on Internal Accounting and Administrative Control Systems**

The Department did not appropriately identify known internal control weaknesses as material weaknesses for inclusion in its biennial report on its evaluation of internal accounting and administrative control systems.

Sections 18.1484 and 18.1485(4) of the *Michigan Compiled Laws* require the Department to evaluate its internal accounting and administrative control systems and to issue a biennial report on the evaluation to the Governor on or before May 1 of each odd numbered year. The report must include a description of any material inadequacy or weakness discovered in connection with the evaluation as of October 1 of the preceding year. Department of Management and Budget Administrative Guide procedure 1270.01 provides guidance to departments on the attributes that would constitute a material inadequacy or weakness, such as adverse consequences that could result from the control weakness or potential exposure to adverse consequences.

Our review of the Department's evaluation for the fiscal year ended September 30, 2000 noted the identification of two control weaknesses related to its information technology (IT) that we determined are material weaknesses:

#### **a. IT Security Plan**

The Department had not established a formal IT security plan. A formal security plan would provide management with reasonable assurance that its information systems are secure and that Department assets and sensitive information are safeguarded against unauthorized use, disclosure, modification, damage, or loss.

#### **b. IT Monitoring and Assessment**

The Department had not established a formal process to monitor and assess the effectiveness of internal control over its information systems. Without regular reviews and assessments of information system internal control, management cannot be assured that its information systems are secure and operating effectively.

The Department informed us that, when it identified these weaknesses, it did not consider them to be material to the Department's internal accounting and administrative control systems as a whole.

## **RECOMMENDATION**

We recommend that the Department appropriately identify known internal control weaknesses as material weaknesses for inclusion in its biennial report on its evaluation of internal accounting and administrative control systems.

## **FINDING (270204)**

### **4. Internal Audit Functions**

The Department's Office of Internal Audit did not conduct audits of the Department's internal information systems. Also, the Office of Internal Audit performed duties that were incompatible with the internal audit function.

Section 18.1486 of the *Michigan Compiled Laws* requires the Department's internal auditor to be organizationally independent with respect to financial audits and it establishes specific functions for the internal auditor to perform. These functions include conducting and supervising audits of the Department's financial activities and operations and informing management of deficiencies in the Department's internal accounting and administrative control system. Our review disclosed:

#### **a. Audits of Internal Information Systems**

The majority of the Department's financial activity is processed through a number of internal information systems that support information recorded in MAIN. For example, the Department distributed revenue sharing and special census payments to local units of governments that totaled over \$1.5 billion and issued approximately \$1.3 billion in individual income tax refunds through internal information systems during fiscal year 2000-01. Also, the Department uses information systems to maintain taxpayer account information.

Audits of the Department's internal information systems assist management by identifying areas in which risk of unauthorized access to confidential taxpayer information, improper financial reporting, and fraudulent financial activity could be reduced to an acceptable level.

#### **b. Duties Incompatible With the Internal Audit Function**

The Department assigned the Office of Internal Audit the duty of administering the Department's security for MAIN and most of its internal information systems. This duty is incompatible with the internal audit function. Although

the internal auditor has a role in information security, having primary responsibility for the Department's information security prevents the Office of Internal Audit from conducting impartial audits and investigations and presenting management with objective conclusions regarding the effectiveness of the Department's internal information systems and MAIN. Also, assignment of this duty diverts the Office's limited resources that may otherwise be available to conduct audits of the Department's internal information systems.

We reported these conditions in our prior audit report. With regard to audits of internal information systems, the Office informed us that, because of limited staffing and its priority to conduct investigative activities, it was unable to conduct these audits as planned. With regard to the Office's administration of the Department's security for MAIN and most of its internal information systems, the Department responded that it has intentions to transfer the security function out of the Office in June 2002.

### **RECOMMENDATIONS**

WE AGAIN RECOMMEND THAT THE DEPARTMENT'S OFFICE OF INTERNAL AUDIT CONDUCT AUDITS OF THE DEPARTMENT'S INTERNAL INFORMATION SYSTEMS.

WE ALSO AGAIN RECOMMEND THAT THE DEPARTMENT NOT ASSIGN THE OFFICE OF INTERNAL AUDIT DUTIES THAT ARE INCOMPATIBLE WITH THE INTERNAL AUDIT FUNCTION.

**The status of the findings related to the financial schedules that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.**

### **Section III: Findings and Questioned Costs Related to Federal Awards**

We did not report any findings related to federal awards.

# OTHER SCHEDULES

DEPARTMENT OF TREASURY  
Summary Schedule of Prior Audit Findings  
As of September 30, 2001

**PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL SCHEDULES**

Audit Findings Not Corrected or Partially Corrected:

**Audit Period:** October 1, 1997 through September 30, 1999  
**Finding Number:** 270001  
**Finding Title:** Internal Audit  
**Finding:** The Department of Treasury's internal auditor was not organizationally independent, had not conducted audits of the Department's information systems, and had performed duties that were incompatible with the internal audit function.  
**Comments:**

- a. The internal auditor reports directly to the State Treasurer.
- b. The Office of Internal Audit is currently conducting an investigation of portions of the income tax information systems in conjunction with two fraud cases.
- c. The compilation of the Department's year-end accruals has been transferred to the Finance and Accounting Division. It is our intention to transfer the security function out of the Office of Internal Audit in June 2002. Also, we are working in conjunction with the Office of Information Technology Services to develop a comprehensive security system for the Department.

**PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS**

There were no findings related to federal awards in the prior Single Audit.

DEPARTMENT OF TREASURY

Corrective Action Plan

As of June 5, 2002

**FINDINGS RELATED TO THE FINANCIAL SCHEDULES**

**Finding Number:** 270201  
**Finding Title:** Service Organization Controls

**Management Views:** We agree that a more formal process to document the effectiveness of the internal control of the financial institution would benefit the Department of Treasury. Financial institutions are highly regulated and audited entities. In light of that and what we consider to be adequate compensating controls, we believe that the risk of loss is negligible. This is borne out by the fact that there has not been a material loss of tax revenues through misappropriation of funds by the financial institution staff.

There are three primary compensating controls:

1. The tax assessment process is a compensating control that is utilized to alert us to processing problems. This process, through taxpayers, helps to identify lost or misapplied funds. The Department assesses taxpayers for insufficient payment or lack of payment. Once taxpayers are assessed, if they disagree with the assessment because they have paid their taxes, they notify us. This allows us to identify lost or misapplied funds. For the volume of transactions, errors and other discrepancies revealed through the tax assessment process are minimal.

2. We maintain constant, ongoing contact with the financial institution with various levels of staff, including visits to the processing location as well as quarterly executive meetings. We have also been working collaboratively with the financial institution to develop performance standards for the services provided.
3. The Unemployment Agency also utilizes the lockbox services of this financial institution. It reviews the controls on a four-year cycle, with annual testing of certain requirements. Its last review yielded confidence in the internal control.

**Corrective Action:**

We will develop formal methods for documenting reviews of the internal control processes at the financial institution. These methods will include: formal documentation of the visits to the financial institution's location and the results of those visits, checklists for visits, continued development of performance measures, and obtaining review services for formal assurances regarding the internal control of the financial services organization. This could encompass an American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards No. 70 (SAS-70) audit, a collaborative review with the Unemployment Agency, a review by the Department's internal audit staff, or another alternative.

**Anticipated Completion Date:** September 30, 2003

**Responsible Individual:** Mary G. MacDowell, Director, Financial Services Bureau

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**Finding Number:** 270202  
**Finding Title:** Approval Controls

**Management Views:** We agree with the finding. While we did not maintain documentation throughout the audit period to support the approval of certain revenue transactions that the auditors tested, we believe the current process for approvals provides adequate controls associated with recording transactions in the proper amount, proper fiscal year, and proper classification. Also, separation of duties is supported by the Michigan Administrative Information Network (MAIN) user classification system that separates data entry and the approval function.

**Corrective Action:** We will, in conjunction with the Office of Financial Management, Department of Management and Budget, review the processes associated with the approval of revenue transactions and records retention and will implement measures necessary to comply with State requirements.

**Anticipated Completion Date:** September 30, 2003

**Responsible Individual:** Mary G. MacDowell, Director, Financial Services Bureau

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**Finding Number:** 270203  
**Finding Title:** Report on Internal Accounting and Administrative Control Systems

**Management Views:** We agree with the corresponding recommendation and will comply.

**Corrective Action:** We will report weaknesses that we consider to be material as a whole to the Department's internal accounting and administrative control systems.

**Anticipated Completion Date:** June 30, 2003

**Responsible Individual:** Julie Croll, Chief Deputy Treasurer

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**Finding Number:** 270204

**Finding Title:** Internal Audit Functions

**Management Views:** We agree with the corresponding recommendations and will comply.

**Corrective Action:**

- a. We will begin conducting audits of the information systems associated with the administration of taxes collected by the Department.
- b. We will transfer the security function from the Office of Internal Audit.

**Anticipated Completion Date:**

- a. September 30, 2003
- b. June 30, 2002

**Responsible Individual:**

- a. John F. Nuyen, Director, Office of Internal Audit
- b. Julie Croll, Chief Deputy Treasurer

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#### **FINDINGS RELATED TO FEDERAL AWARDS**

There were no findings related to federal awards for fiscal years 1999-2000 and 2000-01.

## Glossary of Acronyms and Terms

<b>AICPA</b>	American Institute of Certified Public Accountants.
<b>CFDA</b>	<i>Catalog of Federal Domestic Assistance.</i>
<b>FIA</b>	Family Independence Agency.
<b>financial audit</b>	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
<b>internal control</b>	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
<b>IT</b>	information technology.
<b>low-risk auditee</b>	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
<b>material misstatement</b>	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the results of operations or cash flows in conformity with the disclosed basis of accounting.
<b>material noncompliance</b>	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial

schedule and/or financial statement amounts or on program results.

**material weakness**

A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that either misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

**Michigan  
Administrative  
Information Network  
(MAIN)**

The State's fully integrated automated administrative management system that supports the accounting, payroll, purchasing, contracting, budgeting, personnel, and revenue management activities and requirements. MAIN consists of four major components: MAIN Enterprise Information System (EIS); MAIN Financial Administration and Control System (FACS); MAIN Human Resource System (HRS); and MAIN Management Information Database (MIDB).

**OMB**

U.S. Office of Management and Budget.

**questioned cost**

A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

reportable condition	A matter coming to the auditor's attention relating to a deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) record, process, summarize, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements or (2) administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants.
SAS-70	AICPA Statement on Auditing Standards No. 70.
Single Audit	A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in <i>Government Auditing Standards</i> issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.
SOMCAFR	<i>State of Michigan Comprehensive Annual Financial Report.</i>
subrecipient	A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.
unqualified opinion	An auditor's opinion in which the auditor states that: <ul style="list-style-type: none"> <li>a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or</li> </ul>

- b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules taken by themselves; or
- c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.